U.S. Chamber of Commerce

1615 H Street, NW
Washington, DC 20062-2000
uschamber.com

February 6, 2023

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Request for Comment, Board of Governors of the Federal Reserve System; Principles for Climate-Related Financial Risk Management for Large Financial Institutions (87 Fed. Reg. 75,267-75,271, December 8, 2022)

Dear Ms. Misback:

The U.S. Chamber of Commerce ("the Chamber") appreciates the opportunity to respond to the Board's ("Board" or "agency") request for comment on "Principles for Climate-Related Financial Risk Management for Large Financial Institutions" ("principles" or "proposal").

The Chamber actively collaborates with our members and other stakeholders to promote practices, policies, and technology innovations across industry and government that address our shared climate challenges, particularly to reduce greenhouse gas emissions to the lowest levels possible at the pace of innovation.

These proposed principles follow the actions of other regulators who are also prioritizing the development and implementation of standardized guidance for financial institutions regarding climate risks. In December 2021, the Office of the Comptroller of the Currency (OCC) released a request for feedback on climate-related financial risk management for large banks, and the Federal Deposit Insurance Corporation (FDIC) issued a substantially similar request in March 2022. The Board notes that it consulted with the OCC and FDIC in developing this proposal and that the agencies want to promote consistency as they coordinate in issuing final guidance.[1] We appreciate that the Board desires to collaborate with the other agencies and maintain a risk-based approach to supervision, as well as its recognition that

[1] 87 Fed. Reg. at 75268

climate risk expertise and the incorporation of climate-related risk management frameworks are evolving at financial institutions.

It is critical to point out, however, that in any forthcoming guidance on climate-related financial risk, the agencies should not recommend moving capital away from industries or sectors that may have more environmental risk. Directing capital away from politically disfavored industries can be dangerous for our entire economy, and the Chamber has long been concerned about the potential for regulators to make these types of decisions.[2] Indeed, such an approach could lead to wide swings in regulation as political leadership changes, undermining confidence in our banking system. Additionally, any attempts to use this process to allocate capital may raise questions on whether the regulators are running afoul of the major questions doctrine as articulated in *West Virginia v. Environmental Protection Agency*.

We encourage the Board to limit its focus on supporting financial institutions in their assessments of climate risks only for safety and soundness purposes.

The Federal Reserve Has a Narrow Authority to Address Climate Risk

In a January 2023 speech in Stockholm, Federal Reserve Chair Jerome Powell said the following on the Board's role regarding climate-related financial risk: "it is essential that we stick to our statutory goals and authorities, and that we resist the temptation to broaden our scope to address other important social issues of the day. Taking on new goals, however worthy, without a clear statutory mandate would undermine the case for our independence."[3]

While noting that the Board has narrow responsibilities regarding climate-related financial risks, Chair Powell was clear that policies addressing climate change are the responsibility of the elected branches of government, emphasizing that "without explicit congressional legislation, it would be inappropriate for us to use our monetary policy or supervisory tools to promote a greener economy or to achieve other climate-based goals. We are not, and will not be, a 'climate policymaker.'"[4]

It is clear from the Chair's statement, that he understands that the Board's role in addressing climate-related financial risks is limited in the absence of direct

[2] U.S. Chamber Letter on the Nomination of Sarah Bloom Raskin to Serve as Vice Chair for Supervision. Found at: https://www.centerforcapitalmarkets.com/letter/chamber-letter-on-the-nomination-of-sarah-bloom-raskin-to-serve-as-vice-chair-for-supervision/
[3] Comments at Symposium on Central Bank Independence, Sveriges Riksbank, Stockholm, Sweden (January 10, 2023). Found at: https://www.federalreserve.gov/newsevents/speech/powell20230110a.htm
[4] Ibid.

authorization from Congress. We agree with Chair Powell and strongly encourage the Board to stay within its mandate and avoid climate-related policymaking.

Responses to the Board's Proposed Principles

In the comments below, the Chamber addresses certain aspects of climate-related financial risk management for banks that are included in the guidance.

Governance

The proposal mentions that boards should "acquire sufficient information to understand the implications of climate-related financial risks across various scenarios and planning horizons" and "appropriate resources to support climate-related financial risk management."[5] The Chamber supports market-driven solutions, and many public companies—including banks—are already demonstrating a significant understanding of these risks and are integrating climate-related policies and responsibilities throughout their organizations.[6] Further guidance from the Board should take into account these efforts and the deep understanding of climate risks that banks already possess.

The proposal also notes that bank boards "should consider whether the incorporation of climate-related financial risks into the financial institution's overall business strategy and risk management frameworks may warrant changes to its compensation policies, taking into account that compensation policies should be aligned with the business, risk strategy, objectives, values, and long-term interests of the financial institution."[7] This reference to compensation did not appear in the proposals issued by the FDIC and OCC, which raises the concern that the guidance from the agencies may not be consistent.

While Section 956 of the Dodd-Frank Act confers upon the Agencies the limited authority to prohibit incentive-based compensation plans that provide "an executive officer, employee, director, or principal shareholder" of a covered institution with "excessive compensation, fees, or benefits," or that "could lead to material financial loss"[8] to the institution, the statute does not authorize the Agencies to prescribe and approve terms and features of compensation plans.

---

[5] 87 Federal Register at 75269.

[6] See for example the Chamber's report on materiality of corporate disclosures. *Essential Information: Modernizing Our Corporate Disclosure System*. U.S. Chamber of Commerce Center for Capital Markets Competitiveness (2017). https://www.centerforcapitalmarkets.com/resource/essential-information-modernizing-our-corporate-disclosure-system/

[7] 87 Federal Register at 75269.

[8] 12 U.S.C. § 5641(b).

Congress considered and rejected a broader remit on compensation and limited it to incentive plans within a narrow scope. Other than the consideration of climate as a risk within the ambit of incentive compensation plans, it is unclear as to the appropriate authority of regulators to delve further into this area. The Chamber strongly urges the Board not to violate the plain text of the statute and to avoid prescribing terms in compensation plans.

Strategic Planning

Undue emphasis on climate-related risk in strategic planning could lead banks to spend inordinate time and resources on climate risks when others are more material. Strategic planning for climate-related financial risk is an iterative process. Because climate risks evolve and mature over time and are among a host of risks that banks must consider, banks institute different strategies to prepare for each type of risk. The Basel Committee on Banking Supervision has even noted that "there is a limited amount of research and accompanying data that explore how climate risk drivers feed into transmission channels and the financial risks faced by banks."[9] We urge the Board not to place undue emphasis on climate-related risks over other risks.

Scenario Analysis (Pilot Climate Scenario Analysis Exercise)

We expect the Board to continue to differentiate between climate stress testing and climate scenario analysis. The Chamber also strongly believes that scenario analysis should not be tied to capital or liquidity requirements and that it should only be used to help understand potential risks to a bank's balance sheet and inform its overall risk management strategy.

The Board announced in January 2023, that it will be conducting a Pilot Climate Scenario Analysis (CSA) exercise with the country's six largest banks and released a 52-page instruction manual for the participants. The stated intent of the exercise is to "analyze the impact of scenarios for both physical and transition risks related to climate change on specific assets in their portfolios."[10] The Board is clear that the CSA is "distinct and separate from bank stress tests" and that the exercise is "exploratory in nature and does not have capital consequences."[11] This distinction between traditional stress testing exercises and climate scenario analysis is an important one:

---

[9] *Climate-related risk drivers and their transmission channels*. Basel Committee on Banking Supervision. (April 2021). https://www.bis.org/bcbs/publ/d517.pdf.

[10] Federal Reserve Press Release on Pilot Climate Scenario Analysis Exercise. Found at: https://www.federalreserve.gov/newsevents/pressreleases/other20230117a.htm

[11] Ibid.

> Stress testing for climate change is starkly different from existing macro stress testing and given data and methodology challenges likely to be less reliable. First, the lack of historical data creates important challenges in modeling the interactions between climate, the macroeconomy, and the financial sector, which are necessary requirements in designing plausible and coherent scenarios. Second, climate stress testing attempts to measure outcomes over a much longer time horizon—30 to 50 years rather than nine quarters for macroeconomic stress testing. Third, models that generally relate credit losses to climate risk scenarios require large amounts of information about future counterparty behavior over a long time horizon. Fourth, climate stress tests generally assume that banks take no actions to hedge or reduce exposures to climate risks over that horizon. While macroeconomic stress testing has a similar assumption regarding hedging, and therefore may produce some error over a nine-quarter horizon, this assumption, however, becomes deeply counterfactual over a period of decades."[12]

Banks have a strong desire to comply with supervisory expectations, but the Board should consider phasing expectations in a way that recognizes the availability of data. Long lead times should be permitted, and the Chamber urges regulators not to force changes in the near term. The Chamber is concerned that, while data for understanding climate risk is foundational, it is currently very immature and rapidly changing. American businesses are in the early stages of a decades-long transition to a greener economy, and banks are still trying to determine what data needs to be collected to have a complete understanding of what is useful. Data will improve over time, but the Chamber urges the Board to appreciate that current data collection practices are not at their end state.

The Chamber is also concerned about the audience for the data collected in the CSA exercise and strongly encourages the Board to adhere to its commitment to maintain the confidentiality of individual firm data. While the Board notes that it plans to disclose aggregated data from the CSA on how banks are incorporating climate-related financial risks into their existing risk-management frameworks, the Board does

[12] *Challenges in Stress Testing and Climate Change*. Bank Policy Institute. (October 2020). https://bpi.com/challenges-in-stress-testing-and-climate-change/

not plan to disclose any quantitative estimates of potential losses or any firm-specific information.

The Board should also make use of any data that is collected and reported to international bodies. Coordination with these agencies is key to reducing burdens on banks to provide redundant information. This would streamline requirements for banks and help avoid duplicative, time-consuming efforts to comply with the demands of multiple regulators.

Management of Risk Areas

The Board should consider the challenge banks face in managing climate risk while recognizing that many banks are already doing significant work to mitigate the effects of climate-related risks. We also encourage financial regulators to tailor future guidance based on banks' complexity of operations, risk profiles, size, and scope of operations.

Managing climate risks presents an added layer of difficulty for banks since these risks must be incorporated into a bank's overall risk profile. Board staff has recognized these challenges, noting that "climate-related risks face several challenges to measurement beyond those associated with conventional financial system vulnerabilities and potential shocks, and which will require investment to address."[13] This investment will include "data procurement, and careful analysis of climate-related data to describe specific economic and financial risks" and "is critical to addressing these challenges and producing high-quality research on climate-related outcomes."[14]

The proposed principles also reference physical risks of climate change, like damage to property, and note that financial institutions are likely to be affected by these risks. However, those risks are often negligible and very short-lived. Staff at the Federal Reserve Bank of New York concluded that "FEMA disasters over the last quarter century had insignificant or small effects on U.S. banks' performance" and that "disasters increase loan demand, which offsets losses and actually boosts profits at larger banks."[15]

---

[13] *Climate Change and Financial Stability*. Board of Governors of the Federal System. (March 19, 2021). https://www.federalreserve.gov/econres/notes/feds-notes/climate-change-and-financial-stability-20210319.htm

[14] Ibid.

[15] *How Bad Are Weather Disasters for Banks?* Federal Reserve Bank of New York. (November 2021). https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr990.pdf

Accordingly, it is important for banking regulators to give commenters a context of where climate falls within the larger matrix of risk that must be managed within the banking system.

The proposal notes specific risk areas that banks should account for in their risk management plans:

A. Credit Risk

In the context of climate-related events, staff at the Federal Reserve Bank of New York noted that climate disasters have not proven to be a significant source of risk for banks:

> Our findings suggest the disaster channel is not likely a material source of instability for banks. Even very small banks facing extreme disasters are not substantially threatened. This resilience seems inherent to some degree because disasters increase the demand for loans. Earnings on new loans helps offset losses on loans on the books. In fact, income for larger banks increases after disasters. Local banks also manage to limit exposure to high-risk areas, perhaps reflecting their greater knowledge of such risks. Those endogenous factors seem to buttress banks more than federal disaster assistance.[16]

The Board should consider these findings related to credit risk, in addition to recognizing that relying on credit risk models presents its own set of challenges: "the estimation of credit risk models needed to generate loss projections relies on a limited set of datapoints and has no near-term potential for back-testing. Furthermore, because the loss projections rely so heavily on the judgment of experts, validating the projections is nearly impossible."[17]

B. Liquidity Risk

The Chamber cautions the Board against any unnecessary increase in liquidity requirements that would impair banks' ability to meet customer needs. Banks already adhere to stringent liquidity requirements. The guidance directs banks to "assess whether climate-related financial risks could affect liquidity buffers and, if so, incorporate those risks into their liquidity risk management and liquidity buffers." Banks already incorporate these risks into their risk management profile. As noted

[16] Ibid.
[17] Supra note 10.

above, banks consider all forms of risk, and climate-related risk is only one of a host of risks they must weigh.

C. Legal/Compliance Risk

Compliance issues are always among the biggest challenges banks face in implementing new policies and procedures. Even when banks undertake these changes voluntarily, which many are doing, the transition costs and burdens are significant. The Board should weigh the implications of future regulatory actions on banks' compliance efforts, as such compliance costs are regressive to the size of an institution. Legal and compliance risks will increase for banks as they are required to incorporate climate risk into their overall risk profile. This is important to note as mid-size banks are important providers of financing for Main Street businesses.

The guidelines also note that any consideration of risks by banks should include "possible fair lending concerns if the financial institution's risk mitigation measures disproportionately affect communities or households on a prohibited basis such as race or ethnicity."[18] Banks are acutely aware of the potential impacts of their risk mitigation efforts and are committed to instituting risk measures that do not disproportionately affect any particular communities.

<u>Conclusion</u>

As the Board reviews the current landscape of climate-related risk for banks, and considers possible new guidance, it must recognize the remarkable progress that has already been achieved through market-based approaches and practices and increased communication between banks and their customers. The business community has made building climate-smart, modern, resilient infrastructure among its top priorities. The Board must also continue to recognize, as Chair Powell stated, that it is not a climate regulator and refrain from issuing policies to achieve climate-based goals. The Board should instead afford banks the flexibility to adequately adopt policies that are appropriate to its business.

The Chamber stands ready to work constructively with you on these issues going forward

Sincerely,

[18] 87 Fed. Reg. at 75270

Tom Quaadman
Executive Vice President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce